UNDERWRITING GUIDELINES & FINANCING POLICY

As of January 15, 2003

For the Comprehensive Personal Care Homes Funding Program
For Construction and Permanent or Permanent Only Loans

Eligibility:

Eligible Projects

The sponsor must obtain a resolution from the municipality in which the project to be converted to a Comprehensive Personal Care Home (CPCH) is located reciting that there is a need for this particular project in the municipality. A Certificate of Need from the Department of Health and Senior Services (DHSS) must be received with the application for financing.

Tax Abatement

The Sponsor should obtain a municipal resolution granting a real estate tax abatement and authorizing an agreement for payments in lieu of taxes ("P.I.L.O.T.") for the CPCH under the HMFA s statute, N.J.S.A. 55:14K-37, during the mortgage term. Furthermore, it is beneficial to the project if the tax abatement is pursuant to the HMFA s statute rather than the Long Term Tax Exemption Statute. A 501(c)(3) non-profit Sponsor which have a Certificate of Tax Exemption may not be required under N.J.A.C. 54:4-3.6 to pay real estate taxes and is therefore not required to obtained a P.I.L.O.T. unless it wishes to do so.

Development Team

The development team, which includes the Sponsor, operator (or Health Care Consultant), architect, general contractor, and marketing agent must provide evidence of relevant experience. The subject property must have been in existence as a Licensed Class C Boarding Home or Residential Health Care Facility prior to 1995 and have been in continuous operation since that time.

The Operator if a newly formed company, must display at a minimum, one (1) year of operating a similar type facility and the principals of the company, must demonstrate that they have at a minimum, five (5) years of individual experience in a related field. Likewise, the Sponsor should display a minimum of five (5) years experience in developing or owning this type of housing.

Maximum Loan Amount

Non-profit developers may borrow up to 100% of the total project costs or the appraised value which ever is less provided, that amount can be amortized by the project, as determined by the HMFA. Profit motivated developers may borrow 80% of the total project costs or the appraised value which ever is less provided, that amount can be amortized by the project, as determined by the HMFA. In addition, the loan amount may not exceed the appraised fair market value (at stabilization).

Eligibility (con t):

Preliminary Market Study

A preliminary market study is not required provided the subject project is currently open and operating as one of the acceptable licensed projects qualified to convert to a CPCH. A preliminary Market Study may be required if there is no or a limited number of existing residents. This will be determined at the discretion of the HMFA and the Sponsor will be notified as to the need for the preliminary study in the pre-application or initial application stage.

Operator Questionnaire

The Operator Questionnaire must be submitted as part of the application. The Operator, through the completion of the Questionnaire, must include their proposed activities, staff ratios, room rates for rent, food and services, and referral sources.

Affirmative Housing Marketing Plan

The Affirmative Housing Marketing Plan must be completed and approved at least 9 months prior to construction completion. This plan must be designed to show how the operator intends to reach those persons who are least likely to apply for entry into the project. If the project involves rehabilitation and residents living in the facility, the Affirmative Housing Marketing Plan must be completed and approved prior to commitment.

The affirmative marketing plan should not be confused with the "Marketing Plan" referred to under "Eligibility" which is required as a part of the Operator Questionnaire and due prior to commitment.

Loan Terms:

Debt Service Coverage Ratio

The debt service coverage ratio is the relative cash flow available to meet the annual interest, principal, and HMFA servicing fee payments on debt. The project must achieve and maintain a minimum of 1.30-debt service coverage ratio for a 15-year period. Debt Service Coverage Ratio calculation is as follows:

$$\frac{\text{Net Operating Income}}{\text{HMFA Debt Service + Serv. Fee*}} = \text{Debt Service Coverage Ratio}$$

* See servicing fee at Typical HMFA Fees and Transactions.

Term

Standard term is 30 years. Developers may request a term of less than 30 years.

Lien Status

All loans will be secured by a first mortgage on the land and improvements. If the property is owned subject to a ground lease, the HMFA will require a leasehold mortgage secured by the lease and the improvements; however, the term of the ground lease must at a minimum be for the term of and subordinate to the first mortgage, subject to the HMFA Deed Restriction, and be in all respects satisfactory to the HMFA.

Secondary Financing

The HMFA will permit secondary financing. This financing may be in the form of an amortizing loan provided the project is able to maintain a minimum of a 1.20 debt service coverage ratio including the secondary financing. In no event may the secondary lender institute foreclosure proceedings without the consent of the HMFA.

Security/Collateral

HMFA loans are secured or collateralized by a lien on the land, improvements, project revenues, equipment furnishings and escrows. There is generally no recourse to other assets of the borrower except in the case of fraud or other acts with regard to the project.

Mortgage Interest Rate

The mortgage interest rate is a fixed rate for the term of the mortgage and will be determined based upon the HMFA s actual cost of funds and allowable spread at the earlier of the loan closing or bond sale. For current rates visit the Multifamily Programs Interest Rate section of HMFA's web site.

Rate Lock

The rate is locked one week prior to the pricing of bonds that will fund the loan and will be fixed for the term of the loan. Sponsors are responsible for the interest rate risk prior to that period as the positive or negative change in the interest rate will have the effect of increasing or decreasing the mortgage that the CPCH can support and remain in compliance with the HMFA s Underwriting criteria.

Commitment Term

Construction and permanent loan commitments will expire 90 days after the anticipated construction start date. In the case of permanent only loans, the commitment will expire 90 days after the anticipated construction completion date. The Executive Director may extend this period for two 90-day terms. A written request for extensions must be made to the Agency, at which time it will be determined if the extension is warranted. <u>Commitment extensions should not be considered automatic and may have new conditions added.</u>

<u>Once a commitment and all extensions have been exhausted, the developer must request a new commitment. Any issuance of a new commitment will be under the terms and conditions of the existing underwriting guidelines and will be treated as a new loan.</u>

Fees: (See Typical HMFA Fees and Transactions section under Assisted Living Underwriting Guidelines section in “A Guide to Financing Assisted Living and Opening the Doors to a New Millennium”)

Underwriting Analysis:

Site Acceptance

The HMFA will visit the site to determine that the project is suitable for conversion and HMFA funding.

Real Estate Valuation

The HMFA recognizes the lesser of the appraised value or the Total Project Costs of the realty (or the loan amount to be re-financed) in the most recent arm's length transaction as provided by a "Delineation of Title" history identifying each party associated with the conveyance for a minimum of 10 year or three transactions. The Total Project Costs may include documented carrying costs, expenditures to obtain zoning, environmental or other governmental approvals necessary or useful for the development of the project, and the costs of improvements erected for the benefit of the project. The difference between the actual project cost and the appraised value, if the total project cost is higher, may be recognized for the purposes of Return on Investment.

An independent appraisal will be commissioned by the HMFA to determine value of the site, building and business. The appraisal will be performed in accordance with HMFA Appraisal Standards and Procedures for Assisted Living Residences. If applicable, the value of the federal low-income housing tax credits must be provided. Appraisal Standards and Procedures for Assisted Living Residences can be found in A Guide To Financing Assisted Living Residences And Opening the Doors to a New Millennium or, are available upon request. (Also see Typical HMFA Fees and Transactions section.)

An appraisal may be up-dated no more than twice at which time it may be necessary to order a new appraisal. In no case, should an appraisal be more than six months old at the time of closing. It should further be understood that any increase or decrease in value will be taken into consideration at the time of commitment extensions or re-commitment.

Construction and Permanent Financing

Where the HMFA provides both the Construction and Permanent Financing, a 100% payment and performance bond is required for a term of two years from the date of issuance of the Certificate of Occupancy (CO) or the Architect’s Certification of Substantial Completion, whichever is the later. All bonding companies must be rated with an A.M. Best Rating of B+ or better.

Additionally, the typical budgeted contingency for rehabilitation work is 10% of the construction costs. If there is new construction involved in the project, i.e. a new wing to an existing structure, the contingency for that portion of the conversion may be reduced to 5% of the construction costs. Contingency amount will be determined on a case-by-case basis dependent upon the individual project. In no case will the contingency be less then the 10% referred to above.

A Certificate of Occupancy as well as a License for the new use must be issued by the Department of Health and Senior Services; and acceptance by the HMFA internal Staff of the final audit must occur. All conditions above must be met prior to the release of the Letter of Credit (LOC) or remaining funds. Once approved, the release shall take place within 30 days of that request.

Construction Budget

The construction budget must be supported by a Summary Trade Break Payment Breakdown signed by the contractor. This document and other supporting schedules such as the construction completion schedule and design development drawings must be submitted by the contractor and approved by the Director of Technical Services. Refer to "A Guide to Financing Assisted Living and Opening the Doors to a New Millennium" for the timing of the submission of these documents.

Permanent Financing*

Where HMFA construction financing is not used, the contractor must provide one of the following for two years from the date of issuance of the Certificate of Occupancy (CO) or the Architect's Certification of Substantial Completion, whichever is the later:

- 100% Payment and Performance Bond equal to 30% of the permanent mortgage
- Letter of Credit equal to 10% of the permanent mortgage
- Warranty Bond equal to 30% of construction cost

* **All insurance must be issued by a firm with an A.M. Best Rating of B+ or better.**

It should further be noted that **if** the residents of a facility must be relocated during construction and once construction has been completed, they are not able to return to the facility for any reason, the HMFA will on a case by case basis determine when and under what circumstances it will take the construction lender out. This timing will be dependent upon occupancy projections and could mean that the construction lender will only be taken out at sustaining occupancy. For this purpose, sustaining occupancy is defined as: the point in time when the facility can sustain **all** of its expenses including operations, escrows, reserves and debt service for three consecutive months.

Building Design

The HMFA does not allow the use of EIFS (Exterior Insulation Finish Systems such as Dryvit) and discourages electric heating systems for new construction. It is recommended that the use of these systems be disclosed at the application stage and the HMFA authorize the use of these systems in writing before engaging professionals to embark upon completing design development drawings.

The HMFA also discourages bi-fold doors and balconies. Wherever possible, sponsors should endeavor to make developments as energy efficient as possible.

Operating Budget

The operating budget portion of the Form 10 pro forma must be completed by the Operator and independently from the Sponsor if they are not one and the same. It must provide the number of full-time equivalent employees that are anticipated to work in the CPCH and the anticipated salaries for those employees. Monthly fee should be set by the Operator and shown on the pro forma in the Rent, Food and Services section by unit type. It should further be noted that since the project has been operating under a different license prior to this conversion, the HMFA will want to review at least two years audited financials with all schedules and notes prior to commitment.

Certificate of Need

A Certificate of Need issued by the Department of Health and Senior Services must be provided for the conversion at the time of application for financing.

Ancillary Income

HMFA will recognize ancillary income equal to 1% of gross income from the monthly fees (which consists of costs for rent, food and basic services) if adequately supported by the project narrative. This is highly unusual for a CPCH and must be justified to HMFA's satisfaction.

Community Fees

Community Fees may not be charged to residents of the set-aside units. A one-time Community Fee may be charged to individuals who will occupy the market rate units if the Operator believes it is necessary and can compete with other facilities in the area.

Community fees will not be taken into consideration except as part of the 1% ancillary income currently permitted by these guidelines.

Acuity Income

If Acuity income (levels of care) are used when projecting income to the project, an addendum to the Form 10 pro forma should be used to show the different levels of care and the additional costs of same. When the operator is using this type of pricing, rationale should be given as to the number of persons projected for each level of care being projected. HMFA will determine if the projects for the levels of care are reasonable and if they can be used in supporting the debt when underwriting.

Saturation, Penetration, And Absorption Rates

While HMFA will pay attention to these rates, the weight that will be placed on their importance will be determined by the manner in which the existing business is currently operating, e.g., if the project is full and has a waiting list, less importance will be placed on these evaluating factors than if the project is vacant.

Vacancy Rate

A vacancy rate will be established on a case-by-case basis dependent upon individual circumstances. At no time will a vacancy rate less than 3% be used.

Comprehensive Marketing Plan

The Marketing Plan should be consistent with the Affirmative Housing Marketing Plan. As a condition of the mortgage commitment, all CPCH's receiving HMFA financing commitments must begin aggressively marketing the project six months prior to the date of construction completion. A marketing plan must be included as part of the Operator Questionnaire and must outline the preliminary steps that will be taken to ensure the successful rent-up of the project. If however, the existing project is fully rented or, at 95% occupancy upon application for financing, the plan submitted need only be an outline of what marketing is currently being done and an outline of how they intend to improve upon it, if necessary.

At construction commencement, the Operator must provide an up-date to the Marketing Plan and provide the HMFA a monthly report with regard to their progress.

Environmental Review

A Preliminary Assessment Report as described in N.J.A.C. 7:26E-3.2 is required. Additional assessments, such as a Site Investigation described in N.J.A.C. 7:26E-3.3 et seq., or DEP environmental remediation measures may also be warranted. Rehabilitation projects must provide a plan for asbestos removal and remediation of lead-based paint and radon. A letter of "No further action" from DEP may be required.

A transaction update from the consultant indication that no further pollutants have been introduced to the site will be required on all assessments or investigations prepared more than six months prior to construction state. (See Typical HMFA Fees and Transactions section.)

Medicaid Income:

All loans will be underwritten as though 10% of the units in a project will be funded using the Medicaid Waiver payment. This is effective for all applications received after April 20, 2002. The HMFA recognizes that there are currently no waivers available but must be prudent in its underwriting to be certain that when they do become available, the project can be sustained by the most conservative income estimation.

Professional Liability

Insurance
Contractor
- 100% payment and performance bond
- General liability
- Workmen's compensation
- Contractor's public liability in the sum of $1,000,000/$3,000,000 and property insurance of $250,000/$500,000

Architect
- Architects must have Errors & Omission Insurance of 10% of the construction costs or $250,000, whichever is greater.

- A firm with an A.M. Best Rating of B+ or better must issue all Insurance.

Developer's Fee

The amount of the Developer's fee allowed is limited to 15% of the total development cost excluding land and building, working capital, marketing expenses, escrows, and operating deficit reserves. In addition, the developer's fee may include an additional 5% of the related acquisition costs of the building only.

The following fees are not included in the Developer fee: the architect, engineer, lawyer, accountant, surveyor, appraiser, professional planner, historical consultant and environmental consultant. Financial consultants must be paid out of the developer's fee and may not be added as an additional charge on the pro forma.

If the HMFA is financing the construction and permanent mortgage loan, up to one-half of the developer's fee will be retained in escrow until the project reaches stabilized occupancy and its required debt service coverage. For these purposes, stabilized occupancy is defined as: the point in time when the facility can sustain **all** of its expenses including operations, escrows and reserves, debt service and can meet its debt service coverage ratio. Developers may pledge or defer the remaining portion of their developer fee to the project as equity. The amount allowable will be determined by the HMFA. The developer's fee is earned on a pro-rata basis during the construction period based upon the percentage of construction completion. The un-pledged portion of the developer's fee is payable only when earned and is earned only after the entire pledged portion has been earned.

Escrow Requirements

Escrows must be funded from the capital budget at the time of closing on the construction and/or permanent loan and must remain in place for the term of the mortgage.

*Insurance Escrow - one-half year's premium

Mortgage Insurance Escrow - one-year's premium plus one-quarter of the following year's premium.

*Tax Escrow (if required) - one-quarter of taxes - this may be on real property and/or a payment in lieu of taxes
Debt Service Escrow - one-month's principal, interest and servicing fee payment.

Operating Reserve - one-day operating expenses, including the debt service, as determined by the HMFA.

* Additional escrows may be required at closing for the Agency to make the next payment or renewal.

Working Capital

Working capital is funded at construction loan closing or at the time of the permanent financing only. The funds are generally used to cover the difference between initial cash flow and operating expenses after the project has received its license, including debt service and HMFA fees until the project reaches a sustaining occupancy. This deposit may be in the form of cash or a letter of credit (LOC). This figure is based upon the Agency approved operating expenses and anticipated absorption rate as determined by the HMFA. If the project is fully rented-up at the time of application and continues to remain occupied at an acceptable occupancy rate, the HMFA will determine an appropriate amount of working capital based on the projected rent-up of the new beds. Any remaining working capital may be used to fund the operating reserve. See the section in "A Guide to Financing Assisted Living Residences and Opening the Doors to a New Millennium" entitled "General Information" for the complete Working Capital Policy.

Reserves
Repair & Replacement

$600 per unit should be budgeted for the repair and replacement reserve in he first year of operations, subject to adjustment, and determined by the HMFA in subsequent years. This reserve covers the costs of repair and replacement of all major items and systems associated with a typical multifamily project and the costs for the additional furniture, fixtures and equipment required for a CPCH project.

Furniture, Fixtures & Equipment

A minimum start-up- of $2,900 per unit will be budgeted for all loans. This is a minimum amount and the Sponsor may increase it according to need. It will be funded subject to the maximum loan amount possible.

Operating Reserves

Funded at closing with one day's operating expenses, including the expenses of tenant services and meals, and deposits are to be made gradually building up and equal to 75 days' worth of operating expenses before a return on investment is payable to the owner. This reserve may be set-up in one of two ways: 1) through cash deposits or 2) through the use of a LOC in the form acceptable to HMFA.

Management Fee

HMFA will look at the fee charged for the management of the project on a case by case basis; on average, the management fee will range within 4-6% of gross rents.

Income Targeting

In order for the HMFA to finance a CPCH, the Sponsor must agree to make available a minimum of 50% of the beds in the facility to persons at or below 50% of area median income. It is understood that under the Department of Health and Senior Services' regulations, that any person currently living in the facility to be converted is not permitted to be discharged solely for the purpose of conversion; it is therefore not a requirement of funding that the project be 100% affordable to low-income residents however, it is recommended that the Sponsor strive toward making as many remaining units affordable to low- and moderate-income individuals as are possible without jeopardizing the project's viability.

At initial occupancy, the gross aggregate income of the tenant(s) in each unit (including market rate units) may not exceed six times the annual rent or carrying charges, including the value or cost to them of heat, light, water, sewage, parking facilities and cooking fuel.

The restrictions on tenant income and on rents shall be enforced through a deed restriction on the project and land for the term of the HMFA's mortgage.

Rents

Set-aside unit rents, including utilities, may not exceed 30% of the income for the targeted income selection. Market rate units are not restricted.

Monthly Resident Fees	For the set-aside beds charges for rent, food and basic services are covered in the monthly fee and are capped at 80% of the applicable Median Income. Family members may provide financial assistance where needed for those services outside the basic services provided. For a list of Basic Services, see "A Guide to Assisted Living and Opening the Doors to a New Millennium". The monthly fees for food, rent and services on the market-rate units are not capped. Monthly fees charged for Medicaid recipients follow Medicaid restrictions.
Service Subsidy Escrow	Will be used to subsidize the costs of rent and services for the low-income tenants who may deplete their assets and need assistance. This fund will be held in escrow and administered by the HMFA.
Return on Investment	Sponsors are entitled to a return on investment when the following benchmarks have been met: 1) two consecutive years of sustaining occupancy, 2) all reserve accounts fully funded, 3) surplus cash flow. Developers may receive the first 20% of return on investment as their profit. After the owner has earned a 20% return on investment in any given year, the next 10% must be set-aside in a Service Subsidy Escrow. The developer is permitted to receive any remaining return on investment greater than 30%.
Sale or Prepayment	The HMFA prohibits the sale of the project without prior Agency approval. If the project's mortgage term exceeds 20 years, it may be prepaid at year 20; however, the low-income housing and other HMFA restrictions remain in place through the original mortgage term pursuant to N.J.S.A. 5:80-3.
Tax Credits	CPCH's are not eligible for Tax Credits.

NOTE: **Where not addressed in these guidelines, please refer to the HMFA Standards in the *Assisted Living Underwriting Guidelines For Construction and Permanent or Permanent Only Loans* in A Guide to Financing Assisted Living and Opening the Doors to a New Millennium.**

Call 609-278-7529 for a copy of
"A Guide To Financing Assisted Living Residences And Opening the Doors to a New Millennium."